INVESTOR'S BUSINESS DAILY
TUESDAY, OCTOBER 28, 2008
MUTUAL FUNDS

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Fairholme Sees Market Full Of Values

Holdings Include Pfizer

Manager Berkowitz likes basically sound stocks with distressed prices

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If Fairholme Fund FAIRX ends 2008 with its current year-to-date return, that would be the worst full-year loss in his fund's history. But manager Bruce Berkowitz has a happy face on.

One reason: He's still beating the market. Another reason: "Values today are exceptional," said Berkowitz, whose fund runs $9.3 billion in assets. "I haven't been this happy in a long time."

One reason for that is that Berkowitz likes companies selling at distressed prices.

"That doesn't mean I like distressed companies," he added. "I like it when investors are infatuated with something else — or at least afraid of something that's actually fundamentally sound. I like it when the price is distressed."

Berkshire Hathaway BRKA is an example. Berkowitz bought a lot of his current stake in 2000 — the year his fund opened for business. The stock is now among Fairholme's top holdings, as of the fund's latest disclosure.

"Investors were in love with new things," he said. "They loved tech names and the Internet. Old-line companies like Berkshire Hathaway were selling at distressed levels. We boosted our stake."

Then as now, Berkowitz prized the fact that Berkshire was pumping out a lot of free cash flow for its share price.

"We look at the free cash flow we believe a business can generate in the future," Berkowitz said. "Free cash flow is similar to what (storied value investor) Benjamin Graham would call owner earnings. After paying for supplies, payroll and taxes — whatever you need to maintain the business — it's what the owners can take out without degrading the business. What else matters?"

Berkowitz's focus has put his fund about 10 percentage points ahead of its large-cap blend rivals tracked by Morningstar Inc. so far this year. It's also about 9 points ahead of the S&P 500.

Still, the fund was down in absolute terms 30.16% going into Monday. Its large blend peers averaged a loss of 40.21%. The S&P 500 was down 39.24%.

Over the past five years, the fund's average annual gain was 7.09% vs. a 1.77% average annual loss for its peers and a 1.30% loss for the bogey.

Focused Fund

Berkowitz is aggressive when it comes to backing his bets. The portfolio held only 24 stocks as of March 31. He had 64% of his money in his 10 biggest positions.

Also, Berkowitz has 18% of his money in cash. That's a typical level for him. It enables him to jump on opportunities without having to liquidate one of his other positions.

"A pile of cash will let you buy parts of companies these days at prices not seen since maybe 1974," he said.

Berkowitz says he's been bargain hunting in stressed sectors where stock values have fallen off a cliff.

Among existing holdings, **Pfizer** PFE is a favorite. The drug maker was a top holding and top buy in Fairholme's latest disclosure.

Some investors are worried about the impact of Pfizer's cholesterol-cutting Lipitor going off-patent in a few years. But Berkowitz instead sees a company with a huge cash balance, big free cash flow, giant distribution system and a cost-cutting chief executive.

The fund began to buy earlier this year.

"The stock was stressed by investor perception," Berkowitz said. "But I believe they will become the No. 1 generic drug company in the U.S., with a significant pipeline of new products."

Well, Well

Berkowitz is also bullish on **WellPoint** WLP. No matter which political party wins the White House, Berkowitz sees health maintenance organizations like that playing a key role in federal efforts to foster quality care at low cost.

For the same reason, he likes **WellCare Health Plans** WCG. He began to buy it after its stock plunged, following a raid in October 2007 by FBI agents over billing issues.